
OLR Bill Analysis

sHB 5465 (as amended by House "A")*

AN ACT CONCERNING THE CONNECTICUT AEROSPACE REINVESTMENT ACT.

SUMMARY:

This bill creates a program that compensates large manufacturers proposing industrial reinvestment projects (IRP) for unused state research and development (R&D) tax credits. A manufacturer qualifies for compensation if it meets specified criteria and agrees to spend at least \$100 million over five years on an IRP, which may consist of activities ranging from constructing new plants to hiring and training employees.

The bill authorizes the Department of Economic and Community Development (DECD) commissioner to run the program, specifying the process she must use to (1) certify if manufacturers and their proposed IRPs meet the bill's criteria and (2) enter into contracts providing compensation payments for credits in exchange for undertaking an IRP. The commissioner's authority to enter into reinvestment contracts ends June 30, 2015.

The bill also authorizes the commissioner to determine the amount of unused credits eligible for compensation and specifies the methods she must use to calculate the credit exchange payments. The methods vary depending on an IRP's total eligible expenditures plus the degree to which certain weighted activity factors fall above or below the bill's base levels for each factor.

The bill imposes program, annual, and project payment caps and prohibits manufacturers approved for payments from earning new R&D credits or exchanging them for cash, as the law currently allows.

The bill requires the commissioner to (1) identify other credit exchange options that could help taxpayers (a) grow and (b) create or

retain jobs here and (2) as appropriate, propose legislation authorizing these options.

Lastly, the bill requires the commissioner to report on approved IRPs in her comprehensive annual report to the governor and legislature.

*House Amendment "A":

1. requires the commissioner to begin making credit exchange payments on or after July 1, 2015;
2. expands the type of information reinvestment contracts must specify;
3. eliminates the base levels specified in the original bill and instead requires that they be specified in the reinvestment contract;
4. specifies that only R&D expenditures incurred in Connecticut can be used to calculate credit exchange payments,
5. requires the commissioner to adjust the tables for calculating such payments when a manufacturer certifies base level that are different than those in the reinvestment contract; and
6. specifies that the job retention requirement for small IRPs is part of and not separate from the R&D component.

The bill also makes many technical changes.

EFFECTIVE DATE: Upon passage

ELIGIBLE MANUFACTURERS

The bill allows manufacturers to exchange accumulated state R&D tax credits for credit exchange payments if DECD certifies their proposed IRP and enters into a reinvestment contract with them, as described below. A manufacturer, or a group of manufacturers filing a combined corporation tax return, qualifies for these payments if it:

1. engages in an industrial sector activity, as defined in the federal Office of Management and Budget's *North American Industrial Classification System*, 2012 edition (industrial sectors 31, 32, or 33);
2. employs at least 15,000 people in Connecticut;
3. spent at least \$200 million per year on federally tax deductible R&D in Connecticut during the five full income years immediately preceding the application for IRP certification (see below); and
4. has at least \$400 million in accumulated state R&D credits.

ELIGIBLE IRPs

To qualify for credit exchange payments, an eligible manufacturer must propose an IRP that meets the bill's criteria. Through the IRP, the manufacturer must incur at least \$100 million in eligible expenditures in Connecticut for:

1. buildings, improvements, property, plants, and equipment (physical development);
2. design work, professional fees, surveys and site preparation, remediation and cleanup, demolition, moving and renovation expenses, and other activities directly related to the physical development activities;
3. personal property;
4. federally tax-deductible R&D; and
5. employee hiring and training.

The manufacturer must incur these IRP-eligible expenditures within five "exchange years," the period during which it is eligible for credit exchange payments. The first year begins on the date specified in the contract between the manufacturer and DECD and ends on June 30, 2015. Each successive contract runs from July 1 to June 30. The commissioner must begin making credit exchange payments on or

after July 1, 2015.

IRP CERTIFICATION

Manufacturers seeking credit exchange payments must propose an IRP and submit it to the DECD commissioner, who must certify that it meets the bill's criteria. A manufacturer must submit the request for certification on a form acceptable to the commissioner containing the information she requires. At a minimum, the manufacturer must:

1. provide a detailed plan outlining the IRP,
2. indicate how long it will take to complete it,
3. estimate the IRP's costs, and
4. specify the amount of unused credits the taxpayer proposes to exchange for undertaking the IRP.

The commissioner may require any additional information she needs to evaluate the request. The bill specifies that the amount of unused credits she approves for the payments is subject to the revenue services commissioner's confirmation.

The bill specifies that (1) only the DECD commissioner may decide whether to certify a proposed IRP and (2) the manufacturer cannot construe this authority as (a) a waiver of the state's sovereign immunity or (b) allowing it to sue the state if she denies certification.

REINVESTMENT CONTRACT

Content

The bill's vehicle for the credit exchange payments is the reinvestment contract between the commissioner and the manufacturer. The contract, which the commissioner may execute after certifying the proposed IRP, must specify:

1. each IRP segment;
2. the timeframe for completing the IRP;

3. the total amount of eligible expenditures the manufacturer agrees to make to complete it;
4. the base levels for calculating credit exchange payments for projects seeking over \$200 million in such payments (see below);
5. the amount of the credit exchange payment, determined by the bill's formula;
6. the terms and conditions the manufacturer must satisfy to receive these payments, including information it must submit to the commissioner and provisions giving her access to the relevant records and allowing her to verify their accuracy;
7. a requirement to repay the payments for failing to comply with the contract;
8. how the manufacturer must notify the commissioner about claim disputes under the contract; and
9. any other terms and conditions the commissioner chooses to impose.

The bill exempts reinvestment contracts from the laws inconsistent with the contracts. These laws (1) limit the extent to which credits can be used to reduce a business' tax liability, (2) specify how R&D credits must be calculated, (3) list the order in which credits for different purposes may be used, (4) limit the amount of economic development funds a project may receive, and (5) require legislative approval for such projects when the amount of assistance exceeds specified amounts.

Resolving Disputes

If a manufacturer cannot resolve any claims under the contract, the bill allows it to sue the state in the Hartford Superior Court. The manufacturer must first notify the commissioner by providing such notice as the contract requires. It must also bring the action within two years of this notice. The bill reserves all legal defenses to the state

except sovereign immunity.

CREDIT EXCHANGE PAYMENTS

Form of Compensation

Manufacturers with unused R&D tax credits can exchange them for payments if they propose an IRP. The exchangeable credits may only include those a manufacturer accumulated up to the end of the last income year before it submitted an IRP for certification.

The commissioner may determine how and when she will make these payments, including their form and manner, which under the bill includes corporation business or sales and use tax refunds or offsets. Under current law, the commissioner provides grants, loans, loan guarantees, and other forms of financial assistance to businesses under various economic development programs. If she chooses to provide refunds or offsets under the bill, she must consult with the revenue services commissioner when providing them.

Credit Exchange Payment Caps

The bill specifies how the commissioner must calculate credit exchange payments, which are subject to program, annual, and project caps. The bill caps the total amount of payments under the program at \$400 million and further caps annual payments at (1) \$20 million per year during the first five years the state makes payments under a reinvestment contract and (2) \$33,334,000 per year for the sixth and subsequent payment years under that contract.

The bill also caps the total amount of accumulated credits a manufacturer can exchange under an IRP at the total amount of the project's eligible expenditures. As discussed below, the amount of these expenditures partly determines the amount of credit exchange payments a manufacturer may receive under a reinvestment contract.

The project caps vary depending on the total payment amount and the rules for calculating annual payments. The bill imposes a \$375 million cap on projects entitling a manufacturer to more than \$200 million in credit exchange payments for the entire project or a segment

of it. It also imposes a \$50 million cap on projects entitling a manufacturer to \$50 million or less in credit exchange payments.

The bill bars a manufacturer from making any further use of those credits it exchanges for incurring the eligible expenditures. If the value of those credits is less than the total value of the manufacturer's accumulated credits, the bill implicitly allows the manufacturer to use the credits that are not part of the IRP, as the law requires.

The DECD commissioner must notify the DRS commissioner of the value of the credits she approves for credit exchange payments under a reinvestment contract.

Calculating Credit Exchange Payments—General

The bill provides two methods for calculating credit exchange payments, depending on the total value of payments the DECD commissioner agrees to make in exchange for the manufacturer incurring eligible expenditures under the reinvestment contract. Consequently, it divides IRPs into two categories, each with different rules for calculating credit exchange payments. In both cases, the manufacturer receives the payments only if it complies with the reinvestment contract.

Calculating Credit Exchange Payments for Large IRPs

For IRPs entitling a manufacturer to over \$200 million in credit exchange payments for the entire project or a segment of it (up to the \$375 million cap mentioned above), the credit exchange payments in each of the first five payment years equals a portion of the eligible expenditures incurred during each of those five years.

The DECD commissioner must determine that portion by multiplying the total eligible expenditures incurred during a year by the sum of four "weighting factors" expressed as percentages reflecting the degree to which the manufacturer's actual (1) workforce and (2) R&D and capital expenditure activity levels in Connecticut fell above or below the base level specified in the reinvestment contract. The R&D and capital expenditure levels exclude expenditures incurred

under a reinvestment contract.

The bill specifies the range of activity levels for each weighting factor and the associated weight (percentage), but not the base level, which is specified in the reinvestment contract. The base level is the activity level the manufacturer certifies in the contract. The amount of the credit exchange payment reflects the extent to which each factor's activity level fell above or below the base level.

Table 1 shows the factors the commissioner must use to calculate credit exchange payments for a hypothetical IRP. It identifies the weighting factors, the maximum percentage weighting for each factor, the base level the manufacturer specified in the reinvestment contract, and the range of weighting percentages for activity levels above or below that level.

Table 1: Weighting Factors for Calculating Large IRP Credit Exchange Payments

Performance Factor Components	Performance Factors			
	Employment Level of Engineers in Connecticut	Overall Connecticut Employment Level	Connecticut Payroll Levels	R&D and Capital Expenditure Levels
Maximum Weighting Percentage	20%	30%	30%	20%
Performance Levels	4,350-5,000	12,450-14,400	\$1.370 million - \$1.565 million	\$680.0 million - \$810.0 million
Range of Activity Levels and Associated Weighting Percentages	Below 4,350: 0% 4,900 base level: 18% 5,000: 20%	Below 12,450: 0% 14,100 base level: 27% 14,400: 30%	Below \$1.370 million: 0% \$1.535 million base level: 27% \$1.565 million: 30%	Below \$680.0 million: 0% \$790.0 million base level: 18% \$810.0 million: 20%

As noted above, the commissioner determines an annual credit exchange payment by multiplying the eligible expenditure for a payment year by the sum of the percentages for each weighting factor. For example, if the manufacturer incurred \$10 million in eligible expenditures, employed 5,000 engineers in Connecticut, employed 14,100 people here in all occupational categories (including the 5,000 engineers), spent \$1.535 million on payroll, and made \$810.0 million in

R&D and capital expenditures, the annual credit exchange payment for the manufacturer is \$9.4 million (\$10 million times 94%).

Under the bill, the manufacturer must certify the bill's base levels in the contract to the DECD commissioner within 120 days after executing the reinvestment contract. If the manufacturer certifies different levels, the commissioner may adjust the base levels and recalculate the weighting factors consistent with the bill format. (The bill does not prescribe a method for recalculating the weighting factors.)

Calculating Credit Exchange Payments for Small IRPs

The bill provides a separate method for calculating the credit exchange payments for IRPs entitling a manufacturer to \$50 million or less in such payments. It tacitly allows the manufacturer to divide an IRP or its segments into separate R&D and capital expenditures components and bases the payments on the total spending for (1) each capital component and (2) all R&D components. The R&D component consists of the amount spent on this activity and the number of people retained to perform it in Connecticut during that payment year. (The bill does not specify how the commissioner must determine if the manufacturer meets this employee retention requirement.)

Table 2 shows the required spending and employment retention levels for each component type.

Table 2: Schedule for Calculating Credit Exchange Payment for Small IRPs

<i>Component Type</i>	<i>Minimum Requirement</i>	<i>Credit Exchange Payment Amount</i>
Capital Component	Over \$1 million per component	40% of the total expenditure for each component over \$1 million
R&D Component	Over \$10 million for all components and retain at least 100 employees in Connecticut	\$1 million per component

RESTRICTIONS ON EARNING NEW CREDITS OR EXCHANGING UNUSED CREDITS DURING EXCLUSION PERIOD

The bill prohibits manufacturers approved for credit exchange payments from earning new R&D credits or exchanging them, as the law allows, for a refund equal to 65% of their value during the “exclusion period,” which the bill defines only as whatever period is specified in the reinvestment contract. This ban applies to the 20% incremental and rolling R&D credits (CGS § 12-217j and CGS § 12-217n, respectively) (See BACKGROUND).

The bill does not stop manufacturers approved for credit exchange payments from using, during the exclusion period, any (1) accumulated credits that are not being exchanged under a reinvestment contract or (2) incremental R&D credits. It does not stop them from using other already approved credits or affect their eligibility for them.

LEGISLATIVE REPORT

The commissioner must report on the credit exchange payments in her comprehensive annual report to governor and legislature. In doing so, she must include the number of projects she approved and reinvestment contracts she executed, the status of each certified IRP, the amount of credits exchanged, and the performance levels the manufacturers achieved to obtain the payment amounts.

BACKGROUND

R&D Tax Credit

The law authorizes two types of R&D tax credits against the state’s corporation tax. It authorizes a credit equal to 20% of the annual increase in R&D expenditures over the prior year (CGS § 12-217j) and a rolling credit based on a manufacturer’s size, location, and total annual R&D expenditures (CGS § 12-217n). Regarding the latter, the credit equals the greater of: (1) 3.5% of a manufacturer’s annual R&D expenditures or (2) the amount derived using a two-step formula for calculating credit amounts, whichever is greater. Applying the formula, the manufacturer first calculates the tentative credit amount, based on its total R&D expenditure for the year. The amount ranges from 1% of R&D expenditures totaling less than \$50 million to \$5.5 million plus 6% of R&D expenditures above \$200 million.

The second step limits the actual amount of credit the manufacturer may claim to the greater of the following amounts:

1. 50% of the tax liability without subtracting the R&D credit or
2. the lesser of (a) 200% of the total tentative credit amount, as determined in the first step, or (b) 90% of the total tax bill, without subtracting the R&D credit.

The credit for manufacturers that do not meet the location, size, and annual revenue criteria equals the amount derived from applying the two-step formula.

Accumulating Unused R&D Tax Credits

A manufacturer accumulates R&D credits as well as those for other purposes when the credit amounts exceed its tax liability or the credit (1) cannot be transferred or assigned to another taxpayer or (2) carried forward or backward for application against future or passed tax liability. Other factors that might cause a manufacturer to accumulate credits are the laws barring them from using credits to reduce their annual tax liability by more than 70% (CGS § 12-217zz) and specifying the order in which they may claim credits (CGS § 12-217aa).

COMMITTEE ACTION

Finance, Revenue and Bonding Committee

Joint Favorable Substitute

Yea 50 Nay 0 (04/01/2014)